# Government Bill

# 2009/10:132

Bill
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## Liquidity matching for covered bonds following bankruptcy

The Government presents this bill to the Parliament.

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## Primary content of the Government Bill

The bill sets forth a proposal for provisions of the Covered Bonds Issuance Act (SFS 2003:1223), which aim to clarify the authority of the administrator in the event of the insolvency of an issuing institution. The provisions entail that the bankruptcy administrator is given an express mandate, on behalf of the bankruptcy estate, to take out liquidity loans and enter into other agreements for the purpose of maintaining matching between the cover pool, covered bonds and derivative contracts.

It is proposed that the new provisions enter into force on 1 June 2010.

It is also requested in the bill that the Parliament authorise the Government or the authority appointed by the Government to issue regulations concerning fees which the competent authority may charge pursuant to Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies.

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## 1. Proposed Act of Parliament

The Government proposes that the Parliament:

accept the Government's proposed

1. Act to amend the Covered Bonds Issuance Act (SFS 2003:1223);

and

authorise the Government or the authority appointed by the Government

2. to issue regulations which the competent authority may charge pursuant to Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies (part 7).

## 2. Wording of the Act

The Government has proposed the following wording of the Act.

### 2.1 Proposed Act to amend the Covered Bonds Issuance Act (SFS 2003:1223)

It is hereby prescribed with respect to the Covered Bonds Issuance Act (SFS 2003:1223):

that Chapter 4, section 5 be worded as follows; and

that four new sections, Chapter 4, sections 5-8, and a new heading immediately before Chapter 4, section 5, with the following wording, be inserted in the Act.

*Current wording*

**Chapter 4**

Section 3[1]

A holder of covered bonds and a derivative counterparty are entitled, according to the terms and conditions of the contract, to be paid out of the assets subject to the priority rights, provided that the assets fulfil the terms and conditions stipulated in this Act or there is only a temporary, minor deviation from the stipulated terms and conditions.

*The first paragraph shall not affect the obligations of the administrator pursuant to Chapter 7, section 8, of the Bankruptcy Act (SFS 1987:672)*

*Proposed wording*

**Chapter 4**

***Agreements on behalf of the bankruptcy estate***

*Section 5*

*The administrator may, on behalf of the bankruptcy estate, take out loans, enter into derivative contracts, repurchase agreements and other agreements for the purpose of achieving a balance between, on the one hand, cash flows, currencies, interest rates and interest periods pursuant to the financial terms and conditions in respect of the assets in the cover pool and*

[1] The amendment entails the deletion of the second paragraph.

*derivative contracts entered into, and, on the other hand, the obligations of the issuing institution pursuant to covered bonds and derivative contracts.*

*Section 6*

*In order to fulfil the obligations of the bankruptcy estate pursuant to a loan taken out or an agreement entered into pursuant to section 5, the administrator may, on behalf of the bankruptcy estate, use assets in the cover pool and funds set forth in section 1, second paragraph. Funds which are received pursuant to such loans and agreements shall be administered in accordance with section 4.*

*Section 7*

*Obligations and costs arising for the bankruptcy estate as a result of a loan taken out or an agreement entered into pursuant to section 5 shall, in a distribution of different types of property in the estate, be treated pursuant to Chapter 14, section 18 of the Bankruptcy Act (SFS 1987:672) as expenses for the care and custody of property included in the cover pool.*

*Section 8*

*In determining, pursuant to sections 2 and 3, whether the assets in the cover pool fulfil the terms and conditions imposed in this Act, the financial terms and conditions of loans taken out or agreements entered into pursuant to section 5 shall also be taken into account.*

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This Act shall enter into force on 1 June 2010.

## 3. The matter and its background

In the spring of 2009, a memorandum was received by the Ministry of Finance from the Swedish Bankers' Association entitled "Liquidity matching for covered bonds following bankruptcy". The proposed bill in the memorandum is contained in *Appendix 1*. The memorandum was submitted to interested parties. A list of bodies to which the proposed bill has been referred for consideration, and those who provided comments on their own initiative, is contained in *Appendix 2*.

This bill considers the memorandum's proposal for a clarification to the Covered Bonds Issuance Act (SFS 2003:1223) as regards the bankruptcy administrator's mandate, in the event of the insolvency of an issuing institution, to enter into agreements on behalf of the bankruptcy estate.

### *The Swedish Council on Legislation*

On 28 January 2010, the Government decided to obtain the comments of the Swedish Council on Legislation on the proposed bills, which are contained in *Appendix 3*.

The Swedish Council on Legislation's comments are contained in *Appendix 4*.

In the bill, the Government has essentially followed the proposals of the Swedish Council on Legislation. The views and proposals of the Swedish Council on Legislation are addressed in part 5 and in the comments on the statute. Certain amendments of an editorial nature have also been made to the Submission to the Swedish Council on Legislation.

### *Authorisation concerning fees in respect of credit rating agencies*

In the bill, it is also requested that the Parliament authorise the Government, or the authority appointed by the Government, to issue regulations concerning fees which the competent authority may charge pursuant to Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies. A memorandum concerning authorisation has been referred to interested parties for consideration. A list of the bodies to which the memorandum was submitted is contained in *Appendix 5*. A summary of the submission is available in the matter (Fi2010/917).

# 4. Background

## 4.1 Covered bonds

The Covered Bonds Issuance Act (SFS 2003:1223), which entered into force on 1 July 2004, contains provisions that enable Swedish banks and credit market undertakings (issuing institutions) to issue covered bonds. Holders of covered bonds enjoy special priority rights in certain specific assets (a cover pool). The cover pool must consist, firstly, of loans granted against security in certain property (mortgage loans) or loans granted to certain particularly sound borrowers such as, among others, the Swedish state and Swedish municipalities, as well as certain states, central banks and municipalities in the EEA and the OECD (public loans).

The mortgage loans may consist of loans granted against a mortgage over real estate intended for residential, agricultural, or office purposes, against a mortgage over a site leasehold intended for residential, office or commercial purposes, against a mortgage over tenant-owner rights or against corresponding foreign security. Security for the loans may only consist of property located within the EEA. The share of mortgage loans for commercial properties is limited to 10 percent of the cover pool.

Mortgage loans which may be included in the cover pool are subject to certain maximum loan-to-value ratios. In respect of real estate, site leasehold rights and tenant-owner rights intended for residential purposes, the maximum loan-to-value ratio is 75 percent of the market value. In respect of real estate intended for agricultural purposes, the maximum loan-to-value ratio is 70 percent and in respect of real estate, site leasehold rights and tenant-owner rights intended for commercial or office purposes, 60 percent of the market value.

In addition to mortgage loans and public loans, the issuing institution may also permit certain other assets of a particularly secure and liquid nature (substitute collateral) to be included in the cover pool. The amount of substitute collateral may not exceed 20 percent of the cover pool. If special reasons exist, the Swedish Financial Supervisory Authority may, in a particular case, decide that the amount may for a limited period not exceed 30 percent.

The nominal value of the cover pool must at all times exceed the aggregate nominal value of the claims which may be made against the issuing institution arising from covered bonds (amount matching). The issuing institution's loans and substitute security in the cover pool must be afforded such contractual terms and conditions that a good balance is maintained with the corresponding terms and conditions of the covered bonds. Derivative contracts may be used for this purpose. The issuing institution will be deemed to have achieved such balance where the value of the assets in the cover pool at all times exceeds the value of the debts in respect of covered bonds. In addition, the issuing institution must ensure that the cash flows in respect of the assets in the cover pool, derivative contracts and covered bonds are such that the institution is at all times able to

fulfil its payment obligations to holders of covered bonds and derivative counterparties (liquidity matching). These funds must be maintained separately from the other funds of the institution in a special account (see Chapter 3, sections 8 and 9 of the Covered Bonds Issuance Act).

The issuing institution must maintain a register of the outstanding covered bonds, the cover pool which constitutes security for these bonds, and any derivative contracts which have been entered into for the purpose of achieving a balance between the cover pool and the covered bonds. The register must at all times indicate the nominal value of the covered bonds and the cover pool which is linked to the bonds. The Rights of Priority Act (SFS 1970:979) provides holders of covered bonds and derivative counterparties with special first rights of priority in the cover pool. The rights of priority vest when they are entered in the register.

The Swedish Financial Supervisory Authority supervises compliance by issuing institutions with the provisions of the Covered Bonds Issuance Act and other statutes governing the activities of issuing institutions. To assist in this, the Authority appoints an independent inspector for each institution.

Chapter 4 of the Covered Bonds Issuance Act deals with the insolvency of the issuing institution, and contains separate insolvency rules which are aimed at ensuring that the prospects of the bondholders are unaffected by the bankruptcy of the issuing institution. In the event of bankruptcy, and provided that matching is preserved, the cover pool and the covered bonds will be maintained together and separate from the other assets and liabilities of the bankruptcy estate through the creation of a "liquidation pool" (Chapter 4, section 2, first paragraph). In addition, on the same conditions, the bondholders preserve their rights to payments according to plan (Chapter 4, section 3, first paragraph).

In light of the above, among other things, the credit rating agencies that rate bonds have given the Swedish covered bonds which have been issued the highest possible rating, a rating which generally exceeds the issuer's general unsecured counterparty rating. This has resulted in lower borrowing costs for the issuing institutions and, indirectly, lower interest expenses for consumers with residential loans and other mortgage borrowers.

Since the Covered Bonds Issuance Act entered into force on 1 July 2004, most of the major players on the Swedish mortgage market have applied for and received a licence from the Swedish Financial Supervisory Authority to issue covered bonds. These bonds account today for a significant share of the total borrowing for Handelsbanken, Landshypotek, Länsförsäkringar, Nordea, SBAB, SEB and Swedbank. At the end of 2008, the total outstanding volume of covered bonds issued by Swedish issuing institutions amounted to SEK 950 billion.

### 4.2 Greater focus on liquidity

The rate of repayments in respect of the assets in the cover pool is generally slower than the rate at which the covered bonds that finance the cover pool mature. According to the matching rule in Chapter 3, section 9, third paragraph of the Covered Bonds Issuance Act, the issuing institution must ensure that the

cash flows in respect of the assets in the cover pool, derivative contracts and covered bonds are such that the institution is at all times able to fulfil its payment obligations towards bondholders and derivative counterparties.

If the issuer is placed in bankruptcy, the bankruptcy administrator is obliged to assess whether liquidity matching exists. However, occasional liquidity problems do not prevent a liquidation pool from being created or maintained (Chapter 4, section 2, second paragraph). However, if the administrator is compelled to state that it is not possible in the long-term to fulfil the contractual obligations arising under the registered bonds and derivative contracts, the assets in the cover pool do not fulfil the statutory terms and conditions. The administrator is then compelled to liquidate the pool.

The Covered Bonds Issuance Act lacks express rules as to which measures the administrator may take for the purpose of preserving the liquidity matching between what is referred to as the cover pool, covered bonds and derivative contracts – even after a bankruptcy. However, even without such a provision in the Act, by virtue of the Bankruptcy Act (SFS 1987:672), the administrator is deemed to be entitled to sell assets in the cover pool in order to create liquidity. However, it has been considered uncertain whether the administrator on behalf of the bankruptcy estate can take out loans or enter into repos or derivatives for the purpose of achieving balance in terms of liquidity.

As a result of the turbulence on the financial market in the autumn of 2008, the liquidity issue has been given greater focus, not least from the credit rating agencies. The credit rating agencies have previously relied on the possibility for the administrator to create liquidity by selling or securitising parts of the cover pool. However, in the market conditions which at times prevailed during the financial crisis, it has been questioned whether this possibility is sufficient. The reason for this is that it can be difficult to find willing purchasers of mortgage loans on acceptable terms and conditions when there are general concerns on the markets. It is also uncertain to what extent it is then possible to refinance assets via the capital markets through securitisation.

In these circumstances, it has turned out to be a significant disadvantage that the Covered Bonds Issuance Act has no explicit mandate for the administrator to take out loans and enter into agreements. This lack of an express mandate risks resulting in Swedish covered bonds being given a lower credit rating than previously or, alternatively, a credit rating which is closely linked to and follows the issuer's general unsecured counterparty rating. A lower credit rating would significantly affect both the pricing of, and investors' interest in, the bonds. This would, in turn, affect the interest expenses of mortgage loan customers, as well as the ability of Swedish mortgage lenders to obtain financing and their international competitiveness generally.

### 4.3 International comparison

Most European countries have special legislation concerning covered bonds. In a number of these countries, the bankruptcy administrator or equivalent administrator of the cover pool is given an express mandate to carry out

transactions for the purpose of preserving the balance in terms of liquidity. This applies in, among other countries, Denmark, Norway, Germany and Austria.

*Denmark*

In Denmark, real estate loan institutions (*realkreditinstitutter*) have for a long time now issued a special type of bond (*realkreditobligationer*) which is similar to a covered bond. It has only been possible for real estate loan institutions, and not, for example, banks, to issue this type of bond.

On 1 July 2007, rules were introduced to enable Danish banks to issue a new kind of covered bond, *særligt dækkede obligationer:* "special covered bonds". At the same time, the rules were changed for real estate loan institutions such that, in addition to traditional real estate loan bonds, they can also issue *særligt dækkede* bonds and what are referred to as *særligt dækkede* real estate loan bonds.
The relevant rules for real estate loan institutions and banks differ and are contained in different Acts.

Since 1 July 2007, real estate loan institutions are governed by a new *lov om realkreditlån og realkreditobligationer* (Real Estate Credit Loans and Real Estate Bonds Act) which prescribes, among other things, the following:

> *"I tilfælde af konkurs skal kurator i videst muligt omfang fortsætte eller genoptage honoreringen af realkreditinstituttets forpligtelser i form af renter og afdrag over for indehavere af realkreditobligationer, særligt dækkede realkreditobligationer, særligt dækkede obligationer og andre værdipapirer. I det omfang der ikke er tilstrækkelige midler, betales renter, før udtrækninger foretages. Kurator kan indgå aftaler om finansielle instrumenter, optage lån til betalinger til indehavere af realkreditobligationer, særligt dækkede realkreditobligationer, særligt dækkede obligationer og andre værdipapirer og stille sikkerhed for sådanne lån i aktiver bortset fra realkreditpantebreve tilhørende den eller de serier med seriereservefond, for hvilke betaling finder sted." (32 § andra stycket lov om realkreditlån og realkreditobligationer).*

The real estate loan institution's bankruptcy administrator (*kurator*) is thus afforded an express mandate to enter into agreements regarding financial instruments (repos), take out loans and provide certain security. Even if it is not stated in the wording of the Act, the prevailing opinion in Denmark is that the obligations which the bankruptcy administrator thereby incurs on the estate constitute administration expenses which rank ahead of bondholders, for example.

Special rules contained in the *lov om finansiel virksomhed* (Financial Operations Act) were introduced on 1 July 2007 with respect to covered bonds issued by banks. In the event a bank that has issued covered bonds is placed in bankruptcy, a special administrator (along with the bankruptcy administrator) is appointed to administer the repayment of the covered bonds. The Act contains few provisions about the authority of the administrator, and the issue of whether the administrator is able to take out loans and the like is not covered. According

to the prevailing opinion in Denmark, the administrator should be able to take out loans where it is necessary to ensure liquidity. Where such loans are taken out, the obligations arising are deemed to constitute administration expenses which rank ahead of bondholders, for example.

*Norway*

On 1 June 2007, provisions on covered bonds (*obligasjoner med fortrinnsrett*: Bonds with rights of priority) were introduced into the Norwegian *finansieringsvirksomhetsloven* (Financing Operations Act). The Norwegian system is largely similar to the Swedish system.

The Ministry of Finance in Norway has issued certain regulations by virtue of the *finansieringsvirksomhetsloven*. The following is stated with respect to which measures may be taken after the occurrence of the bankruptcy:

> *"Bostyret kan foreta de disposisjonene som anses nødvendig for å kunne innfri krav med fortrinnsrett i sikkerhetsmassen, herunder å selge aktiva og å utstede nye obligasjoner og derivatavtaler med fortrinnsrett. Bostyret skal så snart som mulig informere eiere av fordringer med fortrinnsrett om beslutninger som antas å være av vesentlig betydning for disse." (3 kap. 14 § fjärde stycket forskrift om kredittforetak som utsteder obligasjoner med fortrinnsrett i en sikkerhetsmasse bestående av offentlige lån, utlån med pant i bolig eller annen fast eiendom).*

Consequently, the regulations give the administrator a mandate to sell assets, issue new bonds and enter into new derivative contracts after the occurrence of the bankruptcy for the purpose of discharging secured obligations. The regulations also state that, where it is not possible to make payments according to plan as the secured obligations fall due, the administrator must suspend payments, after which the general rules under the bankruptcy legislation apply. In this context, the amount of the claims that have rights of priority in the cover pool (including in respect of bonds issued and derivative contracts entered into after the occurrence of the bankruptcy) must be determined on the basis of the circumstances on the date payments are suspended.

*Germany*

Germany has for a long time now had a system for covered bonds, *Pfandbrief*. The German market for covered bonds is well established and dominant in Europe. The German legislation has also acted as a model for several of the countries that have introduced specific legislation in the field of bonds in recent years, including Sweden.

In the event of the bankruptcy of a German mortgage bank, bondholders and derivative counterparties have rights of priority in the register-maintained assets. As a general rule, these assets will not be included in the bankruptcy estate, and bondholders and other holders of priority rights will also not participate in the bankruptcy proceedings. The outstanding bonds do not mature in the event of

bankruptcy, instead the bondholders are in this situation entitled to payment according to plan. However, where the cover pool does not cover the bondholders' claims, separate bankruptcy proceedings are initiated, whereby the bonds become due and payable.

By an amendment to the law in 2005, the special administrator of the cover pool was given the following broad mandate:

> "The cover pool administrator may carry out legal transactions in respect of the cover pools insofar as this is necessary for an orderly settlement of the cover pools in the interest of the full satisfaction of the *Pfandbrief* creditors." (Translation of Chapter 5, section 30, second paragraph, fifth sentence of the *Pfandbriefgesetz*).

The provision referred to above is deemed to entitle the administrator, for example, to take out liquidity loans. Lenders of such loans are granted rights of priority in the cover pool at the same level as bondholders and derivative counterparties.

*Austria*

The Austrian system is respect of cover bonds is similar to the German system. In the event the issuer becomes insolvent, the cover pool is separated from the bankruptcy estate (through the creation of a *Sondermasse*) and earmarked for bondholders.
The administrator is then given the following mandate:

> "*Der besondere Verwalter hat fällige Forderungen der Pfandbriefgläubiger aus der Sondermasse zu erfüllen und die dafür erforderlichen Verwaltungsmaßnahmen mit Wirkung für die Sondermasse zu treffen, etwa durch Einziehung fälliger Hypothekarforderungen, Veräußerung einzelner Deckungswerte oder durch Zwischenfinanzierungen."* (Section 6, third paragraph of the *Pfandbriefgesetz*).

Consequently, the administrator has to ensure that the bondholders receive payments according to plan out of the cover pool by recovering the mortgage loans, selling individual assets out of the cover pool or taking out financing in order to bridge strained liquidity in the short term. Lenders in respect of such financing are granted rights of priority in the cover pool at the same level as bondholders.

## 5. Amendments to the provisions regarding the issuance of covered bonds

**Government's proposal:** Clarifying provisions are introduced into the Covered Bonds Issuance Act (SFS 2003:1223), which deal with the authority of the administrator in the event of the insolvency of an issuing institution. The bankruptcy administrator is given an express mandate, on behalf of the bankruptcy estate, to take out liquidity loans and enter into other agreements for the purpose of maintaining matching between the cover pool, covered bonds and derivative contracts.

**The Memorandum's proposal** is in accord with the Government's proposal.

**The bodies to which the proposal has been referred for consideration:** The majority of bodies to which the proposal has been referred for consideration are in favour of, or have no objection to, the proposal. *The Court of Appeal for Western Sweden* observes that the memorandum does not contain an evaluation of the rules applicable to date. The Court of Appeal is of the opinion that the proposal will result in such a far-reaching extension of the authority of the bankruptcy administrator that it is difficult to reconcile with the provisions of Chapter 7, section 8 of the Swedish Bankruptcy Act. According to the Court of Appeal, it would be more appropriate to aim the rules at a speedy hive-off of the bond activities instead of granting an extended mandate to continue the activities within the scope of the bankruptcy administration. The Court of Appeal also believes that the proposal is difficult to reconcile with the provisions of the Bankruptcy Act in that it treats obligations as costs. In the opinion of the Court of Appeal, the provisions in respect of the issues referred to in the memorandum are more suitably dealt with in the Bankruptcy Act. *Fitch ratings* wants more detailed changes.

**Reasons for the Government's proposal:** The Government wishes to point out initially that, within the scope of this legislative matter, the changes to the way in which liquidation is administered are limited.

The Covered Bonds Issuance Act does not contain any provisions specifying what authority the bankruptcy administrator has in the event of the bankruptcy of an issuing institution. When an issuing institution is placed in bankruptcy, it is no longer entitled to issue new covered bonds. The proposal in the memorandum aims to clarify which measures the administrator may take for the purpose of maintaining liquidity matching between the cover pool, covered bonds and derivative contracts. Even without such express provisions in the Covered Bonds Issuance Act, the administrator, by virtue of the Bankruptcy Act, is deemed to be entitled to sell assets in the cover pool in order to create liquidity. However, it has been considered uncertain whether the administrator on behalf of the bankruptcy estate can, for example, take out loans or enter into derivatives or repurchase agreements (repos) for the purpose of achieving a

balance in terms of liquidity (*cf* Chapter 7, section 8 of the Bankruptcy Act which lends certain support to this being the case). Derivative contracts can be used in connection with covered bonds to handle the differences in interest flows and interest rate and currency risks that may arise between the asset and liability sides of the issuing institution. These differences can arise due to covered bonds being issued in different currencies, on different interest terms and conditions, or with terms that are different to those that apply to the assets in the cover pool. For example, covered bonds issued in euro can finance a cover pool consisting of residential loans in Swedish krona. By using derivative contracts, the currency risk which arises as a result can be reduced. The contracts are generally entered into bilaterally with other banks according to standardised documentation, such as that produced by the International Swaps and Derivatives Association, ISDA. Examples of derivative contracts are interest rate swaps, FX forwards and options.

Repos enable a party holding a security (such as substitute collateral pursuant to Chapter 3, section 2 of the Covered Bonds Issuance Act) to create temporary liquidity. A repo transaction entails that the holder of the security (the seller) transfers the security to a counterparty (the buyer) in exchange for payment. The seller undertakes at the same time to repurchase the security from the buyer, at a future determined date, for a somewhat higher price, equivalent to the original price for "the liquidity loan" plus interest. In the same manner as with derivatives, repos are generally entered into bilaterally with other banks according to standardised documentation.

It was stated in the Submission to the Swedish Council on Legislation that one aim of the proposed amendments is to ensure that a liquidation pool can be created and maintained. The Government shares the opinion of the *Swedish Council on Legislation* that this type of wording can lead to uncertainty as to how this aim accords with the requirement incumbent on the administrator pursuant to Chapter 7, section 8 of the Bankruptcy Act that the estate be wound-up quickly. According to the Swedish Council on Legislation, this should be clarified by inserting a provision equivalent to Chapter 4, section 3, second paragraph which indicates the relationship between the rules currently proposed and Chapter 7, section 8 of the Bankruptcy Act. For the sake of clarity, in the Swedish Council on Legislation's opinion, a reference to Chapter 7 of the Bankruptcy Act should also be inserted in the proposed provision.

The proposed provision aims at increasing the conditions to ensure the most appropriate winding up of the issuing institution's business as possible. The new provisions clarify the possibilities for the bankruptcy administrator to take certain measures, within the scope of his or her administration, to achieve the aim set forth in Chapter 7, section 8. The matching can be preserved after an issuing institution has been placed in bankruptcy and bondholders can continue to receive payments according to plan. Thus, the intention is not for the bankruptcy administrator to create a liquidation pool. This has now been explained in the reasoning above. Like the provision in Chapter 4, section 3, the proposed provision does not constitute an exemption from Chapter 7, section 8 of the Bankruptcy Act. Pursuant to this clarification, the Government considers it unnecessary to refer to the Bankruptcy Act in the Covered Bonds Act.

A reference in the Bankruptcy Act to the currently proposed provision would, of course, clarify the proposed provision. However, it is generally the case that a bankruptcy administrator has to apply a number of rules specific to the industry, depending on the nature of the business he or she is administering. In line with this, a reference should not be inserted in the Bankruptcy Act to the Covered Bonds Act.

*The Court of Appeal for Western Sweden* favours an evaluation of the rules applicable to date. The Government notes that the provisions regarding the insolvency of an issuing institution have never been applied and that there are therefore no concrete cases to evaluate. For the sake of clarity, it should also be noted that the currently proposed amendment to the Act is a result of issues which arose as a consequence of the global financial crisis and changes to assessment criteria at credit rating institutions because of the crisis, and not as a result of specific demonstrated deficiencies in the practical application of the Act.

If the prospects of the bondholders improve as a result of their receiving payments according to plan with greater security even after bankruptcy, this will have a positive effect on the credit rating. This, in turn, reduces the borrowing costs for the issuing institution. A liquidation of the pool under more organised forms should also normally mean that, on the whole, the creditors receive a better distribution in the bankruptcy compared with the case where the assets in the cover pool have to be sold quickly.

According to the proposal, it is made clear that the bankruptcy administrator is entitled to take out loans and enter into derivative contracts, repurchase agreements (repos) and other agreements for the purpose of achieving a balance between the financial terms and conditions for the assets in the cover pool and derivative contracts entered into on the one hand, and the obligations of the issuing institution pursuant to covered bonds and derivative contracts on the other hand. The Court of Appeal for Western Sweden is of the opinion that it would be more appropriate to aim the rules at a speedy hive-off of the bond activities. The Government believes that the amendment to the Act which is currently proposed is more of a clarifying nature. The primary purpose of the amendment to the Act is to grant the administrator access to short-term liquidity. It is made clear that the administrator has an extensive mandate to enter into agreements, not only to achieve a liquidity balance but also to achieve a balance in respect of currencies, interest rates and interest periods (*cf* the matching rule in Chapter 3, section 9 of the Covered Bonds Issuance Act. This is in keeping with the mandate given to administrators in other countries where agreements can be entered into after the occurrence of a bankruptcy. It is thus not always appropriate to have rules which unilaterally aim at hiving off the bond activities.

The bankruptcy administrator should only enter into agreements if, on the date of execution of the agreement, the agreement is deemed to favour bondholders and derivative counterparties and if the assets in the cover pool are deemed to fulfil the terms and conditions imposed in the Act. In this context, the financial terms and conditions of the relevant agreement and any other

agreements of the same kind entered into by the bankruptcy administrator may also be taken into consideration. It can be understood from the definition contained in Chapter 2 of the Covered Bonds Issuance Act that it is presupposed that the derivative contract is entered into between an issuing institution and certain approved counterparties (see also Chapter 4, sections 5-7 of the Swedish Financial Supervisory Authority's Regulations and General Guidelines Governing Covered Bonds [FFFS 2004:11]). After the bankruptcy has occurred, agreements can no longer be entered into by the issuing institution but agreements will be entered into by the bankruptcy estate.

When the bankruptcy administrator enters into an agreement on behalf of the bankruptcy estate, the contracting party receives a claim against the bankruptcy estate (*cf* Chapter 11, section 1 of the Bankruptcy Act. Another alternative would have been to grant the contracting party a claim with rights of priority in the cover pool *pari passu* with the bondholders and derivative counterparties, which would have been enforceable in the bankruptcy. In those foreign rules which permit agreements to be entered into after a bankruptcy, the latter alternative appears to be more common. However, this solution deviates from the Swedish insolvency law rules. In normal cases in Sweden, only claims that arise prior to the adjudication of bankruptcy may be enforced in the bankruptcy (see Chapter 5, section 1 of the Bankruptcy Act). The bankruptcy administrator can generally only enter into agreements that bind the bankruptcy estate, not the debtor in bankruptcy. The fact that the contracting party is granted a claim against the bankruptcy estate that ranks ahead of the secured creditors and creditors with rights of priority should increase the possibility of finding willing counterparties on attractive terms and conditions. The Court of Appeal for Western Sweden questions whether this is an accurate description of the rights of priority between different claims in a bankruptcy. The Court of Appeal is also of the opinion that the bankruptcy administrator's claim for fees risks undermining the cover pool.

The type of claim against the bankruptcy estate which arises in this case should be treated as a cost for the care and custody and sale of property included in the cover pool. Costs of this type should be equated with bankruptcy costs in an application of Chapter 14, section 18 of the Bankruptcy Act. Bankruptcy costs are, in turn, broken down into special and general bankruptcy costs. Property which is subject to special priority rights should firstly bear costs specifically pertaining to that property, i.e. special bankruptcy costs (Chapter 14, section 18, first paragraph of the Bankruptcy Act). On the other hand, the rules state that general bankruptcy costs may not firstly be taken from property which is subject to special priority rights (Chapter 14, section 18, second paragraph of the Bankruptcy Act). The fact that costs specifically pertaining to certain property must be paid before payments to the secured creditors (bondholders and derivative counterparties in this case) by way of the special right of priority should not be controversial.

The more distinct possibilities for the bankruptcy administrator to act means there are greater conditions to enable the particular cover pool to be maintained, as long as the terms and conditions of the Act are fulfilled, which benefits bondholders and derivative counterparties. In relation to the size of the cover

pool, the bankruptcy administrator's claim for fees is considered to be very small. The bankruptcy estate’s obligations pursuant to executed agreements will be satisfied from the cover pool. In the proposed wording of the Act (as well as in the Covered Bonds Issuance Act in general), a cover pool is mentioned. However, this does not prevent an issuing institution from establishing more than one cover pool (*cf* Ds 2001:38 p. 109 *et seq*.). Where a number of cover pools have been created and the administrator enters into agreements to achieve a balance for a particular cover pool, the bankruptcy obligation which arises will be satisfied from the assets in that cover pool (*cf* Chapter 14, section 18, first paragraph of the Bankruptcy Act). However, the obligations may not be satisfied from another cover pool if it may prejudice any party with a separate right of priority in the cover pool (*cf* Chapter 14, section 18, second paragraph of the Bankruptcy Act).

Since the new counterparties receive a bankruptcy claim in the bankruptcy and are thereby paid ahead of the secured creditors, it is possible that opposing interests arise. The funds to which the bankruptcy administrator obtains access by entering into new agreements will likely on the whole be used to pay bonds at the rate at which they mature. The agreements will be satisfied from the entire cover pool. Bondholders with bonds that mature earlier might therefore be favoured over bondholders with bonds that mature later if the assets in the cover pool are insufficient to pay all creditors holding rights of priority in the cover pool and creditors with bankruptcy claims which are to be satisfied from the cover pool. However, the bankruptcy administrator should not enter into this type of agreement unless the assets in the cover pool are deemed to be sufficient to pay in full all creditors with rights of priority in the cover pool and creditors with bankruptcy claims which are to be satisfied from the cover pool by having recourse to the assets in the cover pool. This follows directly from the requirement that the bankruptcy administrator may enter into the agreements for the purpose of fulfilling matching requirements and also that the financial terms and conditions in the new agreements are taken into consideration in conjunction with matching. The interests of creditors without rights of priority are thereby also protected. These creditors are also protected by the fact that the bankruptcy estate's obligations pursuant to executed agreements will be satisfied from the cover pool.

It may also be noted that, even today, opposing interests may arise between bondholders holding bonds that mature shortly after the occurrence of the bankruptcy when the liquidation pool is matched and bondholders holding bonds that mature when the pool is no longer matched (see Government Bill 2002/03:107 page 88 *et seq*, in which an obligation to provide a return in this situation is rejected).

Before the issuing institution has been placed in bankruptcy, rights of priority in respect of the assets in the cover pool can only be created for holders of covered bonds and counterparties in derivative contracts (*cf* section 3 a of the Rights of Priority Act). Other legal actions taken by an issuing institution do not give the counterparties equivalent rights of priority. The scope of the legal actions that the bankruptcy administrator has a mandate to take (“to take out loans, enter into derivative contracts, repos and other agreements”) after the

bankruptcy has occurred, with the result that a claim against the bankruptcy estate arises, is extensive. The purpose of this is for the administrator to be able to select the alternative that is most appropriate to achieve matching and to not have to be restricted to issuing bonds and entering into derivative contracts, for example.

The future-oriented assessments which the administrator is required to make pursuant to the Covered Bonds Issuance Act and pursuant to this proposal can be complicated. To assist in these assessments, the administrator may hire professional advisors such as an accountancy firm, investment bank or other appropriate advisor (*cf* Chapter 7, section 11 of the Bankruptcy Act).

Pursuant to Chapter 7, section 10 of the Bankruptcy Act, the administrator is required, on more important issues, to consult with the supervisory authority and, in particular, affected creditors, unless a bar exists to this. However, in many cases it will probably be of such urgency that new agreements be entered into that it will not be possible to contact all affected parties. It is also likely in practice to be so difficult to contact all of the creditors that, for this reason, it should be considered that a bar exists. This applies in particular to the bondholders, who can be expected to be large in number, whose identity is often difficult to determine, and who are widely dispersed in geographical terms. The holding of bonds can also change over time. Where the bankruptcy administrator makes the assessment that the terms and conditions for entering into new agreements have been fulfilled, the interests of creditors should also be deemed to have been taken into consideration sufficiently and they should not therefore need to be contacted specifically.

## 6. Entry into force

**The Government's proposal:** The amendments to the Covered Bonds Issuance Act will enter to force on 1 June 2010.

**The memorandum** did not make any proposals in this respect.

**The bodies to which the proposal has been referred for consideration:** A number of bodies to which the proposal has been referred for consideration stress the importance of the amendments to the Act being implemented as soon as possible.

**The reasons for the Government's proposal:** As a result of the turbulence on the financial markets in the past year, greater focus has been placed by credit rating agencies on liquidity (part 4.2). This, in turn, has resulted in the credit rating agencies now changing their assessment criteria. The clarification in the Act is being introduced to avoid the Swedish covered bonds having a lower credit rating due to uncertainties concerning the possibilities for the bankruptcy administrator to retain liquidity matching. It is therefore appropriate that the proposed amendments to the Act enter into force as soon as possible, which is considered to be on 1 June 2010.

## 7. Authorisation concerning fees in respect of credit rating agencies

**Government's proposal:** The Government or the authority appointed by the Government be authorised to issue regulations concerning fees which the competent authority may charge pursuant to Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies.

**The proposal in the memorandum** corresponds to that of the Government.

**The bodies to which the memorandum concerning authorisation has been referred for consideration:** *The Swedish Financial Supervisory Authority* and *The Swedish National Financial Management Authority* support the proposal. *The Swedish National Financial Management Authority* maintains that authorisation should also be granted in statutory form and points out that the wording "to issue regulations concerning fees" does not entail that the fees may be at the authority's disposal. The other bodies to which the memorandum concerning authorisation has been referred for consideration did not submit any comments.

**Reasons for the Government's proposal:** On 7 September 2009, Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies [2] (the "EU Regulation") entered into force. Other than a couple of provisions which will take effect on later dates, the EU Regulation took effect on the same day.

The EU Regulation aims to contribute to higher quality for credit ratings which are issued within the European Union and contains, among other things, provisions concerning the supervision of credit rating agencies. According to the EU Regulation, the supervision of credit rating agencies must be effected by the competent authority in the home Member State (the Member State in which the relevant credit rating agency has its registered office) in co-operation with other relevant competent authorities and with the assistance of the Committee of European Securities Regulators (CESR).

Not later than 7 June 2010, each Member State must designate a competent authority (Article 22). Credit rating agencies must submit their application for registration no earlier than 7 June 2010 (Article 40). The competent authority of the home Member State may charge registration and/or supervisory fees to the credit rating agency (Article 19). The fees must be proportional to the costs which arose for the competent authority in the home Member State. The provisions of the EU Regulation are not intended to affect the application of relevant provisions in national legislation concerning supervisory fees or similar fees (reason 57). Fees can therefore be charged in accordance with the provisions of national legislation in a relevant country.

[2] EUT L 302, 17 November 2009, p. 1 (Celex 32009R 1060).

Work has begun on adapting Swedish legislation to the EU Regulation. In the memorandum entitled “Credit Rating Agencies” (Ds 201:7), a proposal is made for a new Act on credit rating agencies. However, this Act will not be able to enter into force until 1 August 2010 at the earliest. A competent authority must therefore be designated in a different procedure not later than 7 June 2010. The Government is expected to designate the Swedish Financial Supervisory Authority as the competent authority by making an amendment to the Regulation containing directions for the Swedish Financial Supervisory Authority (2009:93).

The Swedish Financial Supervisory Authority should also be given the ability to charge fees for registration and supervision. It is important that this ability exists as early as the time at which applications for registration can be submitted because the work involved in evaluating an application for registration is expected to be extensive and may involve relatively high costs for the competent authority. However, the new planned Act on credit rating agencies will not be in force at this time.

According to Chapter 8, section 3, of the Swedish Constitution, as a general rule, regulations on, for example, supervisory fees are generally issued by way of an Act. However, Chapter 8, sections 9 and 11 of the Constitution state that the Parliament can also authorise the Government or the authority appointed by the Government to issue regulations concerning supervisory fees. Such authorisation can be granted in an Act or in another form.

The Parliament should therefore make a decision before 7 June 2010 as to whether to authorise the Government or the authority appointed by the Government to issue regulations concerning fees.

In a general authorisation, the Parliament has delegated to the Government the power to issue regulations concerning application fees and service fees for administrative authorities (Bill 1989/90:138, Report 1989/90:FiU38, Government document 1989/90:289). However, there has been criticism of the authorisation because, among other things, there are uncertainties as regards its scope (see Swedish National Audit Office 2004:17, p. 23 *et seq*. and MOU 2007:96, p. 138 *et seq.*).

In light of the criticism which has been directed against the Government’s earlier general authorisation concerning application and service fees, the Parliament's authorisation should include all fees which are provided for in the EU Regulation, i.e. including application and service fees. As pointed out by the *Swedish National Financial Management Authority*, there is also cause for the Government to consider whether authorisation should also be granted in an Act. The best place for this would be the legislative matter relating to the proposed Act on credit rating agencies.

Concerning the comments made by the *Swedish National Financial Management Authority* regarding the fees not being at the authority’s disposal, it is clear from Bill 2003/04:1, Report 2003/04:FiU1 and Government document 2003/04:42 that the Parliament has already approved of some of the fees now at issue also being at the Swedish Financial Supervisory Authority’s disposal.

# 8. Consequences of the proposal concerning covered bonds

## 8.1 Consequences for holders of covered bonds and derivative counterparties

The proposed clarification in respect of the possibility for the bankruptcy administrator to take out loans and enter into other agreements is aimed at improving the conditions for ensuring that matching is preserved after the issuing institution has been placed into bankruptcy, that the particular cover pool can be maintained, and that bondholders and derivative counterparties are able to continue to receive payments according to plan. This generally results in a more profitable liquidation of the bankruptcy estate, which benefits, among others, holders of covered bonds and derivative counterparties.

Potential opposing interests which may arise between the new counterparties with bankruptcy claims and the secured creditors have been addressed in part 5.

## 8.2 Consequences for other (unsecured) creditors in the event of the bankruptcy of the issuing institution

The proposal improves the conditions for a profitable, organised liquidation of the bankruptcy estate, which should also benefit the issuing institution’s unsecured creditors even if it may entail that the bankruptcy estate is liquidated at a slower rate.

Potential opposing interests which may arise through the bankruptcy administrator entering into agreements have been addressed in part 5.

## 8.3 Consequences for issuing institutions

The proposal aims to avoid Swedish covered bonds being given a lower credit rating (or a credit rating which is closely linked to and follows the issuer's general, unsecured, counterparty rating). Maintaining a high credit rating for Swedish covered bonds affects both the pricing of, and the investors’ interest in, the bonds, and is therefore positive for the ability of Swedish issuing institutions to obtain financing and their international competitiveness generally. It is not anticipated that the proposal will have any consequences in terms of costs for issuing institutions.

## 8.4 Consequences for the issuing institution's borrowers

Maintaining a high credit rating for Swedish covered bonds means continued access to an attractive source of financing for mortgage lenders and, therefore, indirectly, lower interest expenses for consumers with residential loans and other mortgage borrowers.

## 8.5 Consequences for State finances

*The Court of Appeal for Western Sweden* favours a more detailed assessment of the financial consequences of the proposal. The Court of Appeal notes that the bankruptcy proceedings will be more drawn out and therefore result in an increase in bankruptcy costs, which in certain cases the state may have to bear. According to the Court of Appeal, a more extensive duty to register may also entail a corresponding increase in monitoring activities by the Swedish Financial Supervisory Authority. As previously mentioned (part 5), the provisions currently in effect regarding an issuing institution's insolvency have not been applied at all since the Act entered into force on 1 July 2004. It is therefore not anticipated that the proposal will have any consequences in terms of costs for the state or affect the resource requirements of the Swedish Financial Supervisory Authority, including its monitoring activities, other than only marginally. Any additional costs will be financed within the limits of the Swedish Financial Supervisory Authority's budget.

## 8.6 Other consequences

It is considered that the proposal will not entail any need to provide special information.

Given the greater focus placed by credit rating agencies on the liquidity issue and the fact that the uncertainty that arose concerning the relevant provision may have material financial consequences, it is important that the law be passed as soon as possible.

# 9. Comments on the statute

## 9.1 Proposed Act to amend the Covered Bonds Issuance Act (SFS 2003:1223)

**Chapter 4**

**Section 3**
The *second paragraph* has been removed (see further part 5).

**Section 5**
The proposal has been addressed in part 5.

The section, which is new, governs which agreements the bankruptcy administrator may enter into on behalf of the bankruptcy estate. The bankruptcy administrator is given an express mandate to take out loans, enter into derivative contracts, repurchase agreements (repos) and other agreements (e.g. securities loans) for the purpose of achieving a balance between, on the one hand, the financial terms and conditions for the assets in the cover pool and derivative contracts entered into, and, on the other hand, the issuing institution's obligations pursuant to covered bonds and derivative contracts.

The expression "take out loans" is intended to cover entering into both bilateral and syndicated loan agreements and loan facility agreements, as well as bond issues and other debt instruments on the capital market. Compared to the proposal in the memorandum, the references to section 5 which are contained in sections 6 and 7 have, following comments from *the Swedish Bar Association*, been clarified so that they refer to "a loan taken out or an agreement entered into pursuant to section 5" (not just "an agreement entered into pursuant to section 5"). *The Court of Appeal for Western Sweden* is of the opinion that the requirement "for the purpose of" should be tightened. The Court of Appeal refers to the fact that the foreign rules which were the template for the proposal require that the measures must be "necessary" or "required". The Government notes that no such requirements have been imposed in the Danish statutory provisions. In Norway, Germany and Austria, the requirement for necessity/compulsion aims at discharging the covered bonds. However, the proposal at hand has been drafted in such a way that the authority may be used for the purpose of achieving balance in terms of liquidity. A requirement which is too strict might offset the purpose of the clarifying supplement to the Act.

The administrator is given an extensive mandate to enter into agreements not only to achieve a liquidity balance, but also to achieve a balance in respect of currencies, interest rates and interest periods (*cf* the matching rule in Chapter 3, section 9). Section 5 discusses which prerequisites should exist to enable the bankruptcy administrator to use the opportunity to enter into agreements. In order to clearly define and clarify the responsibility of the bankruptcy administrator, according to REKON (The Reorganisation Administrators' and Bankruptcy Trustees' Organisation in Sweden), the prerequisites for ensuring that the bankruptcy administrator can enter into agreements should be clear

from the wording of the Act. In the Government's opinion, it is not appropriate to specify further the prerequisites in the wording of the Act.

As the *Swedish Council on Legislation* has stated, the section proposed in the Submission to the Swedish Council on Legislation appears long and clumsy. Therefore, according to the Swedish Council on Legislation's proposal, the section has been divided up into several sections (see below).

**Section 6**

The proposal has been addressed in section 5.

The section, in its new form, has been revised and redrafted according to the proposal of the Swedish Council on Legislation. The section provides that the loans and agreements entered into pursuant to section 5 and cash flows thereunder are treated in the same way as, for example, flows under derivative contracts entered into prior to the bankruptcy. In addition, the administrator is expressly entitled to use assets in the cover pool to fulfil the bankruptcy estate's obligations under executed agreements. By virtue of the provision, the administrator may, among other things, use substitute collateral which is included in the cover pool to enter into repos or as a basis for borrowing.

Funds which are received due to loans and agreements entered into pursuant to section 5 will be administered in accordance with section 4. The funds are thereby covered by the rights of priority for holders of covered bonds and derivative counterparties in accordance with section 1, second paragraph. The *Court of Appeal for Western Sweden* questions whether any agreements entered into by the bankruptcy administrator should also not be subject to the duty to register pursuant to section 4. However, in the Government's opinion, such a procedure should be avoided for reasons related to the structure of the system.

**Section 7**

The proposal has been addressed in part 5.

The section, in its new form, governs the obligations and costs incurred by the bankruptcy estate due to loans taken out and agreements entered into pursuant to section 5. When the bankruptcy administrator enters into an agreement on behalf of the bankruptcy estate, the contracting party receives a bankruptcy claim (*cf* Chapter 11, section 1 of the Bankruptcy Act). The reference in the section to the Bankruptcy Act entails that the bankruptcy estate's obligations under executed agreements will be satisfied from the cover pool (see further section 5).

**Section 8**

The proposal has been addressed in part 5.

The section, in its new form, contains a rule regarding what must be taken into consideration in assessing whether matching exists. In the event of bankruptcy, and provided that matching is preserved, the cover pool and the covered bonds will be maintained together and separate from the other assets and liabilities of the bankruptcy estate (section 2, first paragraph). In addition, on the same conditions, the bondholders preserve their rights to payments according to plan (section 3).

According to the section just referred to, in the matching assessment pursuant to sections 2 and 3, the administrator is also required to take into account the terms and conditions of agreements entered into pursuant to the new section 5, i.e. the cash flows and other rights and obligations arising from such agreements. This ensures that derivative contracts, for example, entered into before and after the occurrence of the bankruptcy are taken into account in the same manner when matching is being assessed.

**Entry into force**

The proposal has been addressed in part 6.

As stated by the Swedish Council on Legislation, it should be possible to delete the transitional provision in section 2 because the new provisions do not replace the former provisions but entail a clarification.

Appendix 1

# The memorandum's proposed bill

Proposed amendment to the Covered Bonds Issuance Act (SFS 2003:1223)

It is hereby prescribed that a new section, section 5, with the following wording, be inserted in Chapter 4 of the Covered Bonds Issuance Act (SFS 2003:1223).

Section 5

*Agreements entered into on behalf of the bankruptcy estate*

The administrator may, on behalf of the bankruptcy estate, take out loans, enter into derivative contracts, repurchase agreements and other agreements for the purpose of achieving a balance between cash flows, currencies, interest rates and interest periods pursuant to the financial terms and conditions in respect of the assets in the cover pool and derivative contracts entered into on the one hand, and the obligations of the issuing institution pursuant to covered bonds and derivative contracts on the other hand.

In order to fulfil the obligations of the bankruptcy estate pursuant to an agreement entered into pursuant to the first paragraph, the administrator may, on behalf of the bankruptcy estate, use funds set forth in section 1, second paragraph and assets in the cover pool. Funds which are received from counterparties pursuant to such agreements shall be administered in accordance with section 4.

Obligations and costs incurred by the bankruptcy estate arising from an agreement entered into pursuant to the first paragraph shall, in a distribution of different types of property in the estate, be treated as expenses for the care and custody of property included in the cover pool pursuant to Chapter 14, section 18 of the Bankruptcy Act (SFS 1987:672).

In determining, pursuant to sections 2 and 3, whether the assets in the cover pool fulfil the terms and conditions imposed in this Act, the financial terms and conditions in agreements entered into pursuant to the first paragraph shall also be taken into account.

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This Act shall enter into force on [•].

# Bodies to which the proposed bill has been referred for consideration and those who, on their own initiative, provided comments on the memorandum entitled “Liquidity Matching for Covered Bonds”.

The Bank of Sweden, the Court of Appeal for Western Sweden, the Swedish National Debt office, the Swedish Competition Authority, the Swedish Tax Agency, the Swedish Financial Supervisory Authority, the Swedish Enforcement Authority, the Swedish Securities Dealers' Association, the Third Swedish National Pension Fund, the Association of Swedish Finance Houses, the Swedish Insurance Federation, the Swedish Bar Association, the Faculty of Law at the University of Stockholm, the Faculty of Law at the University of Uppsala, the Swedish Federation of Business Owners, Landshypotek, REKON (The Reorganisation Administrators’ and Bankruptcy Trustees’ Organisation in Sweden), the Swedish Society of Financial Analysts, SBAB, the Swedish Confederation for Professional Employees, the Swedish Confederation of Professional Associations, the Swedish Trade Union Confederation (LO), the Swedish Bankers' Association and Fitch Ratings.

Appendix 3

## Proposed Act to amend the Covered Bonds Issuance Act (SFS 2003:1223)

It is hereby prescribed that a new section, Chapter 4, section 5, and a new heading immediately before Chapter 4, section 5, with the following wording, be inserted in the Covered Bonds Issuance Act (SFS 2003:1223).

| *Current wording* | *Proposed wording* |
|---|---|
| | **Chapter 4** |
| | ***Agreements on behalf of the bankruptcy estate*** |
| | *Section 5*<br>*The administrator may, on behalf of the bankruptcy estate, take out loans, enter into derivative contracts, repurchase agreements and other agreements for the purpose of achieving a balance between, on the one hand, cash flows, currencies, interest rates and interest periods pursuant to the financial terms and conditions in respect of the assets in the cover pool and derivative contracts entered into, and, on the other hand, the obligations of the issuing institution pursuant to covered bonds and derivative contracts.*<br>*In order to fulfil the obligations of the bankruptcy estate pursuant to a loan taken out or an agreement entered into pursuant to the first paragraph, the administrator may, on behalf of the bankruptcy estate, use assets in the cover pool and funds set forth in section 1, second paragraph. Funds which are received from counterparties pursuant to such agreements shall be administered in accordance with section 4.*<br>*Obligations and costs arising for the bankruptcy estate as a result of a loan taken out or an agreement entered into pursuant to the first paragraph shall, in a distribution of different types of property in the estate, be treated pursuant to Chapter 14, section 18 of the Bankruptcy Act (SFS* |

*1987:672) as expenses for the care and custody of property included in the cover pool.*

*In determining, pursuant to sections 2 and 3, whether the assets in the cover pool fulfil the terms and conditions imposed in this Act, the financial terms and conditions of loans taken out or agreements entered into pursuant to the first paragraph shall also be taken into account.*

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1. This Act shall enter into force on 1 July 2010.
2. If a petition for bankruptcy has been filed prior to the Act entering into force, the former provisions shall apply.

Appendix 4

# Comments by the Swedish Council on Legislation

Extract from the minutes of a meeting held on 17 February 2010

**In attendance:** Former Justice of the Supreme Administrative Court Rune Lavin, Justice of the Supreme Court Ella Nyström and former Parliamentary Ombudsman Nils-Olof Berggren.

**Liquidity matching for covered bonds following bankruptcy**
Pursuant to a submission to the Swedish Council on Legislation dated 28 January 2010 (the Ministry of Finance), the Government has decided to obtain the Swedish Council on Legislation's opinion regarding the proposed Act to amend the Covered Bonds Issuance Act (SFS 2003:1223).

The proposal has been presented to the Swedish Council on Legislation by Ingela Grönquist, legal adviser at the Ministry of Finance.

The Swedish Council on Legislation makes the following comments on the proposal:

It is proposed in the submission to the Swedish Council on Legislation that provisions be introduced in the Covered Bonds Issuance Act regarding the authority of the bankruptcy administrator in the event of the insolvency of an issuing institution. The provisions entail that the bankruptcy administrator is given an express mandate, on behalf of the bankruptcy estate, to take out liquidity loans and enter into other agreements for the purpose of maintaining matching between what is referred to as the cover pool, covered bonds and derivative contracts.

Chapter 4, section 5

The submission states that the new section is intended to clarify which measures the administrator may take for the purpose of preserving the liquidity matching in order to ensure that what is referred to as a liquidation pool pursuant to section 2 can be created and subsequently maintained.

Fundamental provisions regarding a bankruptcy administrator's obligations and authority are contained in the Swedish Bankruptcy Act (SFS 1987:672). It can be queried whether the provisions currently being proposed regarding the administrator's authority should also not be included in the Bankruptcy Act. However, the rules on secured bonds are distinctive and it would appear most appropriate to insert the new provisions among these rules. However, in the Swedish Council on Legislation's view, for the sake of clarity, a reference

should be inserted in Chapter 7 of the Bankruptcy Act to the section currently proposed.

Chapter 7, section 8 of the Bankruptcy Act provides that the administrator is under an obligation to safeguard the common rights and best interests of creditors, and to take all measures which promote a profitable and speedy winding-up of the estate. When it states in the submission that the purpose of the proposed provisions is to ensure that a liquidation pool can be created and maintained, uncertainty may arise as to how this purpose accords with the requirement that the estate be wound-up quickly. It has come to light during the presentation that the new provisions will not affect the administrator's obligations pursuant to Chapter 7, section 8 of the Bankruptcy Act. In the Swedish Council on Legislation's view, this should be clarified, for example by inserting a provision corresponding to Chapter 4, section 3, second paragraph which specifies the relationship of the rules currently proposed to Chapter 7, section 8 of the Bankruptcy Act.

The proposed section appears long and somewhat clumsy, particularly in comparison with the other provisions of the chapter. This might be rectified by dividing it up into several sections.

The first sentence of the second paragraph makes a distinction between loans and agreements. As a result, loans should also be mentioned specifically in the second sentence. The Swedish Council on Legislation proposes that the second sentence read as follows:

Funds which are received pursuant to such loans and agreements shall be administered in accordance with section 4.

Transitional provision

It should be possible to delete the transitional provision in section 2 because the new provisions do not replace the former provisions but, according to that which is stated in the submission, entail a clarification.

Appendix 5

## Bodies to which the memorandum concerning authorisation has been referred for consideration

The National Board of Trade, the Swedish Financial Supervisory Authority, the Swedish National Financial Management Authority, the Swedish Chambers of Commerce, the Confederation of Swedish Enterprise, the Swedish Federation of Business Owners, the Association for Generally Accepted Principles in the Securities Market, and the Swedish Securities Council.

## The Ministry of Finance

Extract from the minutes of a Governmental meeting held on 4 March 2010

In attendance: Prime Minister Reinfeldt, Chairman, and Cabinet Ministers Odell, Husmark Pehrsson, Larsson, Erlandsson, Torstensson, Carlgren, Hägglund, Björklund, Carlsson, Littorin, Billström, Adelsohn Liljeroth, Krantz

Reporter: Cabinet Minister Odell

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The Government adopts Government Bill 2009/10:132: Liquidity matching for covered bonds following bankruptcy